

**PROPOSAL FOR A MARKET
ANALYSIS PROGRAM**

**FOR THE WASHINGTON STATE
OFFICE OF THE COMMISSIONER**

November 30, 2005

Prepared by:

Susan T. Stead
Nelson, Levine deLuca & Horst LLC
280 North High Street
Columbus, OH 43215

TABLE OF CONTENTS

Executive Summary	3
Background	4
Methodology	7
Development of Market Analysis	9
Market Analysis Standards	11
Critical Components of a Market Analysis Program	12
Observations	13
Recommendations	16
Market Analysis Program	16
Legal Authority	16
Market Analysis	18
Use of NAIC Databases	21
Continuum of Regulatory Responses	22
Elimination of Routine Market Conduct Examinations of Domestic Insurers	24
Participation in the Market Analysis Working Group	25
Interdivisional Cooperation and Sharing of Information	25
Education	27
Interstate Cooperation	28
Uniformity for Investigations and Market Conduct Examinations	29
Resources	30
Organization and Staffing	30
Non-Staff Resources	34
Computer System Requisites	34
Other Resources	35

APPENDICES

Appendix A	Draft Market Conduct Surveillance Law
Appendix B	Insurance Compliance Self-Evaluative Privilege Act
Appendix C	Technical Assistance Advisory
Appendix D	48.03.060. Examination Expense
Appendix E	48.03.070. Witnesses-Subpoenas-Depositions-Oaths
Appendix F	Market Regulation Investigation Guidelines
Appendix G	Market Conduct Uniform Examination Outline
Appendix H	The Standardized Data Request (SDR)
Appendix I	Market Analysis Competencies – Skills, Knowledge, Abilities
Appendix J	Acronyms
Appendix K	Draft Market Conduct Surveillance Law (Version II)
Appendix L	Draft Market Analysis Law

EXECUTIVE SUMMARY

The use of market analysis in insurance regulation provides the regulator with the information and methods necessary to monitor the state's insurance marketplace identify trends, changes and emerging issues, to target insurers for regulatory intervention, and to allocate resources where they can be most effective to protect consumers. Market analysis requires certain technical capabilities and sufficient staff with the requisite skills and training. After evaluating the current market oversight activities of the Washington State Office of the Commissioner and the evolving standards and best practices for market analysis, the following recommendations are made.

- ◆ Creation of a Market Regulation Unit consisting of a team of market analysts, a team of compliance analysts and a team of examiners.
- ◆ Performance of the continuum of regulatory responses.
- ◆ Implementation of uniformity standards and guidelines for analysis, investigations, examinations and collaborative actions.
- ◆ Regular interdivisional communications and information sharing.
- ◆ A department computer system that is fully integrated, flexible in terms of data-mining, data access, reporting, that allows online data submission and comports with all performance standards set by the National Association of Insurance Commissioners.
- ◆ Active participation in the NAIC's Market Analysis Working Group and Collaborative Action Working Group.
- ◆ Elimination of the requirement to conduct periodic market conduct examinations of domestic insurers.

Background

Traditionally, those states that have been the most active in market conduct regulation used an exam-based system similar to that used by financial examiners. Under this system, lengthy examinations or audits of an insurer's non-financial practices (e.g. claims handling, underwriting, rating and policyholder services) would be conducted to determine whether the company was complying with state insurance laws.

The concept of market analysis developed as a result of a growing realization that market oversight and regulation was important for the protection of consumers yet the traditional exam-based model of market oversight could be ineffective, costly and often an inappropriate response to certain types of problems in the market place. In addition, no state is likely to have sufficient resources to regularly examine all insurers that are licensed to do business in the state and most do not have sufficient resources to examine even their domestic insurers. Larger companies complained that they were subject to duplicative and redundant market conduct examinations yet there were companies that had never had a market conduct exam. Regulators began searching for ways to improve their ability to identify problems and trends in the marketplace and to identify those insurance companies that present the greatest risk of harm to consumers. Recent events have caused insurance regulators to take a hard look at market analysis and new methods of assuring compliance.

In 2002, the Government Accountability Office (GAO) (formerly, the General Accounting Office) studied the market conduct oversight activities of nine states. At page 8 of its report issued in September 2003, "Insurance Regulation – Common Standards and Improved Coordination Needed to Strengthen Market Regulation, the GAO emphasized the importance of market analysis:

Among other things, market analysis can provide information on insurance companies' compliance with applicable laws and regulations, highlight practices that could have a negative effect on consumers, and help identify problem companies for examination.

Also at page 8, the GAO acknowledged that complaint analysis is insufficient for effective market analysis.

Analyzing complaints and complaint trends does provide regulators with useful and important information and should be part of any market analysis program. However, other types of information can also help regulators identify and deal with market conduct issues, including data from financial reports, rate-and-form filings, other company filings, routine and special requests for company data, and information from other federal and state regulators.

In 2003, the National Association of Insurance Commissioners (NAIC) issued its "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan." In that

document, the NAIC leadership recognized the importance of market regulation. In fact, it was one of the first topics, second only to consumer protection. The NAIC stated:

Market analysis to assess the quality of every insurer's conduct in the marketplace, uniformity, and interstate collaboration...the goal of the market regulatory enhancements is to create a common set of standards for a uniform market regulatory oversight program that will include all states.

The NAIC went on to state that the three pillars of the enhanced market regulatory system will be market analysis, market conduct and interstate collaboration. With respect to market analysis, the NAIC stated that"

[I]t is imperative that each state have a formal and rigorous market analysis program that provides consistent and routine reports on general market problems and companies that may be operating outside general industry norms. To meet this goal:

- (1) Each state will produce a standardized market regulatory profile for each "nationally significant" domestic company. The creation of these profiles will depend upon the collection of data by each state and each state's full participation in the NAIC's market information systems and new NAIC market analysis standards; and
- (2) Each state will adopt uniform market analysis standards and procedures and integrate market analysis with other key market regulatory functions.

At the end of 2003, the NAIC adopted a Market Analysis Handbook that contains standards, guidelines and technical assistance for market analysis. In 2004, all states were expected to participate in a certain level of standard market analysis and to achieve a minimum use of the NAIC's databases. At least 49 states completed the analysis.

While market analysis was developing as a tool for monitoring the insurance market and targeting companies for regulatory attention, work was also being done on guidelines for sharing information through the Market Analysis Working Group (MAWG) and new processes for conducting collaborative market conduct actions and examinations.

In 2005, another NAIC working group began developing a set of core competencies for market regulation programs. States will be expected to certify that they meet the core competencies in 2006. Many persons in the industry and within state regulation anticipate that the core competencies will eventually become the standards for an accreditation program for market regulation.

In August, 2004, the House Financial Services Committee released a proposal for legislation to reform state regulation of insurance. A hearing was held by the committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises in June 2005 on the proposal which is entitled "State Modernization and Regulatory Transparency Act and is commonly known as the SMART Act. It has not yet

been introduced in Congress but it contains many significant reform and uniformity requirements and deadlines for state insurance regulators. In the area of market conduct, the SMART Act would require states to adopt the NAIC Market Conduct Surveillance Model Act (or a similar model), an act which strongly emphasizes market analysis and regulatory reviews other than traditional examinations. The SMART Act specifically mentions accreditation. It also would require states to adopt the NAIC's Market Analysis Handbook and the uniform examination guidelines. A state's failure to adopt such models would mean the preemption of any state laws that are inconsistent with the models and that the models would automatically apply in such states. The SMART Act restricts a state's ability and discretion to conduct market conduct examinations but allows for-cause examinations that are based upon market analysis. Although there has been some discussion that the SMART Act may be introduced in the current session of Congress, to date, there has been no such movement.

Finally, many trade associations, including the American Insurance Association, the American Council of Life Insurers and the Council of Insurance Agents and Brokers, have publicly supported a federal charter option for insurers. A federal charter option would permit insurers to be regulated by a single federal entity and escape most state oversight and regulation.

These recent efforts to promote market analysis, to transition traditional examination-based programs into market-analysis driven models and to reform state insurance regulation in general have made it clear to state insurance regulators that changes are necessary. The challenge in establishing any market analysis program at the present time is that market analysis techniques and programs continue to develop and evolve within the NAIC committees and within the various states. Even the basic analysis program that was initiated and completed by 49 states in 2004 changed in 2005 and more changes are planned for 2006. The NAIC is continually developing electronic tools and reports to help enhance market analysis activities. It is critical, therefore, that any market analysis program be sufficiently robust and flexible to allow the state to satisfy developing standards, participate in developed programs, meet all standards for self-certification or accreditation and to be in a position to satisfy any requirements that Congress may impose on state insurance regulators.

In the Request for Proposal (RFP), the Washington State Office of the Insurance Commissioner (OIC) recognized the critical need for a systematic and comprehensive market analysis program, and recognized that accreditation of market regulation programs is likely to occur. Although the RFP referred to a market analysis program, the term "market analysis" is often used to include much more than mere data collection and analysis. For example, the NAIC Market Analysis Handbook addresses a continuum of regulatory responses and interstate collaboration as well as analysis. After due consideration of all of the models, handbooks, proposals, the ongoing work of the various NAIC committees, congressional proposals and studies and related information, it is apparent that more than simply data collection and analysis is necessary for a market analysis program that will satisfy the developing standards and expectations. Therefore,

this proposal includes additional elements and often uses the term “market regulation” to encompass the broader concept.

The term “insurer” as used throughout this proposal is intended to include all entities holding a certificate of authority, including health maintenance organizations and health care service contractors. Historically, some entities like fraternal benefits societies are treated somewhat differently than other insurers under state insurance laws, and it will be up to the OIC to determine whether any of those entities should be exempt from market analysis and market regulation.

Finally, in preparing this proposal, a concerted effort was made to not repeat the information and guidance that is provided in the NAIC Market Analysis Handbook. It is presumed that the OIC is familiar with the contents of the handbook and will use it as a resource in implementing a market analysis program.

Methodology

In developing this proposal, meetings were held with various levels of staff at the OIC. Department reports, services, staffing and organization, website, current data collection and analysis, and resources were studied. The insurance statutes and regulations of Washington were analyzed.

Meetings were held with the following individuals from the OIC:

Company Supervision Division:

James T. Odiorne, Deputy Insurance Commissioner
Leslie A. Krier, Chief Market Conduct Examiner
Dennis Edward Julnes, Chief Financial Analysis
Sandy Ray, Market Conduct Examiner

Consumer Protection Division:

John Hamje, Deputy Commissioner
Catherine Rogerson, Manager, Consumer Advocacy
Mike Huske, Chief Investigator
Sue Davidson, Market Conduct Examiner
Liz Mercer, Program Assistant (SHIBA) (telephone conference)

Legal Affairs Division:

Carol Sureau, Deputy Commissioner (telephone conference)
Ted Bader, Investigator
Nancy Heley, Administrative Assistant

Legislative:

Mary Clogston, Legislative Liaison

Operations Division (Information Systems):

Soung Kim, Information Technician
Julie Ryan-Ice, ITSS 3
Sandra Brede, Information Technician

Policy Division:

Jim Tompkins, Staff Attorney

Rates and Forms Division

Beth Berendt, Deputy Commissioner
Alan Hudina, Life & Annuities Manager,
Donna Dorris, Health & Disability Manager
Lisa Smego, Property & Casualty Manager
Lee Barclay, Senior Actuary

The following general topics were covered in the meetings:

Division functions
Statutory charges and duties
Current staff levels and positions
Staff duties
Staffing challenges (hiring, pay, qualifications)
Division strengths
Division weaknesses
Data/information collection
Reports generated
Analysis/use of data and information collected
Additional information that would be useful in market oversight
Interdivisional cooperation, communications, sharing of information and meetings
Coordination of exam/investigatory/enforcement efforts
Suggestions for improvements to OIC market oversight
Types of regulatory responses used for market problems
Industry education efforts

The following sources were studied to assure that the proposed market analysis program would satisfy the NAIC standards and the OIC's goals of meeting accreditation standards:

- ✓ NAIC Market Analysis Handbook and proposed changes to the Handbook.
- ✓ Collaborative Actions Guidelines (proposed for the Handbook)
- ✓ NAIC Market Conduct Surveillance Model Act
- ✓ An industry-supported version of a Market Conduct Surveillance Act.
- ✓ Draft set of Core Competencies for market regulation (currently under development)
- ✓ Proposal for State Modernization and Transparency in Regulation Act (SMART)

- ✓ Testimony on the proposed SMART Act from the June 16, 2005 hearing before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises.

The ongoing work of the NAIC Market Regulation and Consumer Affairs (D) Committee and its various working groups and subgroups was monitored by personal attendance at an interim meeting of the Uniformity Working Group and participation in conference calls of the Market Conduct Annual Statement Subgroup and the Market Regulation and Consumer Affairs (D) Committee. This work was monitored closely because of the constant changes being made to expectations and standards for states' market analysis programs, proposed changes to the Market Analysis Handbook, the Market Conduct Annual Statement and the ongoing work of the Uniformity Working Group to develop a set of four core competencies for market regulation that is expected to be completed by the end of 2005.

Several states have enacted legislation or issued bulletins pertaining to market analysis, confidentiality, self-evaluative privilege, and the use of best practices organizations. These were reviewed and considered as well as the Self-Evaluative Privilege Model Act adopted by the National Council of Insurance Legislators.

Telephone conferences were conducted with the following individuals from other state insurance departments in an effort to identify best practices.

Paul Hogan , Chief Market Conduct Examiner, Arizona
Maria Chavira, Market Analysis Supervisor, Arizona
Carol O'Bryan, Chief Market Analyst, Colorado
Sam Binum, Chief of Regulatory Review, Florida
Larry Weaties, Assistant Deputy Director, Illinois
Sharron Burton, Chief Examiner, Kentucky
Kent Dover, Chief Examiner of Market Conduct, New Hampshire
Charles Rapacciulo, Assistant Deputy Superintendent, New York
Lynette Baker, Data Specialist Supervisor, Ohio.

Informal discussions were also had with representatives of various trade organizations and others in the industry.

Development of Market Analysis

Market analysis in insurance regulation is evolving daily and state regulators are continually trying new techniques, adopting terminology, developing new systems and revising programs. There is growing belief that market conduct examinations are not always the most effective or efficient method of identifying or handling problems in the market place and that states must adopt and implement other methods.

Market analysis is generally defined as the collection and analysis of data to use in monitoring market activity for the industry as a whole and for targeting insurance

companies that may present some risk of harm and/or noncompliance. Another term that is sometimes used interchangeably with market analysis is market regulation. Generally, however, the term “market regulation” is broader than market analysis. In fact, there is a pending proposal to combine the NAIC’s Market Analysis Handbook and Market Conduct Examiners Handbook into a single “Market Regulation Handbook.” The current Market Analysis Handbook, at page 1, describes market regulation.

Broadly speaking, the purpose of a state’s market regulation program is to assess how well the market as a whole, and the individual companies that make up that market, are meeting consumers’ needs, and then to take appropriate action if problems are identified. As insurance departments evaluate market conditions and companies’ performance, they have three basic mechanisms for gathering information: examinations and investigations of specific companies; surveys and periodic reporting requirements designed to gather market conduct data; and the analysis of existing information that departments already collect for other purposes.

The NAIC has said that the purpose of a state’s market regulation program is “to assess how well the market, as a whole and the individual companies that make up that market, are meeting consumers’ needs and then to take appropriate action if problems are identified. Market Analysis Handbook (2004), p. 3. There is a definition of market analysis at page 4 (including proposed amendments dated August 8, 2005):

A market analysis program is a system of collection and analysis of data and other information that can enable a regulator to do the following:

- Provide the fundamental elements of a system for market analysis for all companies and all lines of business (proposed).
- Screen and follow-up with insurers whose results are out of the norm and help focus resources on insurers with potential market conduct problems (proposed).
- Provide a good approach for monitoring the performance of a newly formed or newly licensed company (proposed).
- Identify general market disruptions and important market conduct problems as early as possible and to eliminate or at least limit the harm to consumers;
- Better prioritize and coordinate the various market regulation functions of the department and establish an integrated system of proportional responses to market problems; and
- Provide a framework for collaboration among the states and with federal regulators regarding identification of market conduct issues and market regulation.

Market Analysis Standards

Currently, the NAIC has the following minimum market analysis standards and resources available for a state to adopt and use in a market analysis program: The Market Analysis Handbook (under revision), the Market Conduct Surveillance Model Law, a draft set of Core Competencies for market regulation (expected to be adopted in December 2005), Market Conduct Uniform Examination Outline (including preplanning checklist), a set of Uniform Data Calls and a set of Uniform Guidelines for Investigations.

For 2005, state insurance regulators will be scored on their achievement of several tasks in the market regulation area. Specifically, states expected to have a Market Analysis Chief and a Collaborative Actions Coordinator who are active with the NAIC's Market Analysis Working Group (MAWG), to have take recommended action on companies it referred to MAWG, to complete Level 1 analysis on the recommended number of companies, to meet participation standards for using NAIC databases (Complaint Database System (CDS), Exam Tracking System (ETS), Regulatory Information Retrieval System (RIRS) and Special Activities Database (SAD)) and electronic submission of all CDS and RIRS entries. Additional objectives are expected for 2006. In addition, according to the Market Analysis Checklist, all states are supposed to have a systematic interdivisional communication program that surveys other work units at least quarterly and to follow the guidelines for collaborative actions.

As discussed above, the recent development of a set of core competencies for market regulation is seen by many as the precursor to an accreditation program similar to what currently exists for financial regulation of insurers. It is expected that the list of core competencies will expand. Any market analysis program must be designed to meet these standards. The current draft (September 27, 2005) of the Core Competencies, as prepared by the NAIC's Uniformity Working Group, contains the following requirements.

1. Resources

Regulatory Authority – A state needs to be able to analyze, examine or investigate companies whenever necessary, and must have the ability to perform the continuum of regulatory responses, access records of regulated entities, and keep records confidential. The state needs to have adopted an unfair trade practices act that is substantially similar to the NAIC model.

Staff and Training – A state needs sufficient, qualified staff to perform the continuum of regulatory responses, data collection and analysis, examinations and investigations. A Collaborative Actions Coordinator and Market Analysis Chief must be appointed. The state must perform ongoing market analysis and prioritize market actions.

2. Market Analysis

Analysis – A state must gather information from a variety of sources and analyze it to develop a baseline understanding of the marketplace and to identify insurers or practices for further review that appear to deviate significantly from the norm or that present a risk of harm to consumers.

Data Collection – A state must use the Market Analysis Review System, collect data as required by the commissioner, collect data for the Market Conduct Annual Statement (if participating) and use the standardized data calls when there is a need for data collection.

3. Continuum

Market Conduct Examinations – A state must have standards for determining when an examination should be called. The state should adhere to the standards in the Market Conduct Examination Handbook (which is in the process of being incorporated into the Market Regulation Handbook), and the examination uniformity guidelines.

Investigations – A state should conduct investigations in accordance with the established standards. Investigations and formalities should be posted in the appropriate NAIC databases.

4. Interstate Collaboration

Participation in MAWG, including calls and surveys.

Timely entry and participation in NAIC databases.

Providing notice to the domestic Collaborative Actions Designee or Market Analysis Chief when considering a market action.

Verifying receiving states can ensure confidentiality of materials and data.

Following the collaborative actions guidelines for recommendations to MAWG.

Critical Components of a Market Analysis Program

There are numerous components that are critical for an effective, efficient and flexible market analysis program. Each component is discussed in more detail below. The critical components include:

- The appropriate legal authority to perform the various functions involved in market analysis and market regulation.
- Sufficient resources (staff, technology, travel) to perform the various functions of market analysis and to keep up with changes in the insurance market, market analysis techniques and procedures and to meet evolving standards for self-certification and/or accreditation.
- Interdivisional cooperation and sharing of information.

- The ability and resources to respond to a problem with a continuum of regulatory responses.
- Participation in the NAIC's Market Analysis Working Group.
- Participation in the NAIC's Collaborative Actions Working Group, including specific collaborative actions.
- Appropriate use and submission of data to the NAIC's databases: CDS, ETS, RIRS, SAD.
- Use of other NAIC market analysis tools, including the Market Analysis Bulletin Board (MABB), the Market Analysis Review System (MARS) and the Market Initiative Tracking System (MITS).
- The ability to keep certain data, information, analysis and records confidential as appropriate.
- Educational outreach efforts.

Observations

During interviews with department staff and review of the activities and resources of the OIC, it became apparent that the department has a dedicated, concerned and professional staff, many of whom have given much thought to how the department could improve its oversight of the insurance industry. Like many organizations, the department has both strengths and weaknesses. Most of the weaknesses, however, are due to a lack of staff and other resources and can be readily improved with sufficient resources.

Despite a computer system that does not readily permit sharing of data and information, there are efforts among some divisions and staff to share information with other divisions. For example, it appears that the market conduct staff works closely with the financial analysts. This is positive because of the overlap between the functions and the use by both of certain financial ratios. The market conduct staff also routinely seeks information from other divisions when preparing for an exam or planning an exam schedule. Such preparation can aid in targeting particular issues or practices of a company for review.

Although the use of TeamMate software is not required in any market analysis initiatives or goals, the department is one of few states that are already using it for market conduct examinations.

There is obvious recognition among the Rates and Forms staff that companies with continuous problems with filings may have compliance problems in other areas such as claims. Although there is currently no investigative unit to handle problems involving

insurers, the Rates and Forms Division often takes responsibility to look into an issue and gather the information necessary to correct or resolve the issue.

Various divisions collect data that could be enhanced to make it more valuable and useful for market analysis purposes.

Various divisions share an interest in helping insurance companies comply and avoiding compliance problems. For example, the Rates and Forms Division is considering offering filing seminars and developing filing checklists. Better education of the industry is a means of preventing problems and non-compliance and should be part of a market analysis program.

A new computer system is under development. This is intended to permit better sharing of data among divisions, centralized storage of data, and greater flexibility in data analysis, reporting and trending, among other benefits.

Mandatory market conduct exams every five years of domestic insurers is a practice that is contrary to most market conduct reform efforts and should be eliminated. Such oversight by the domestic regulator makes sense on the financial side of regulation and is, in fact, the preferred method under most circumstances, under both financial accreditation standards and recent developments in insurer licensing standards (e.g. Accelerated Licensure Evaluation Review Techniques (ALERT)). To protect Washington consumers, however, the department must be able to monitor the market conduct of all insurers that are licensed in and doing business in the state. Any insurer, domestic or foreign, has the potential for harming consumers with illegal or unfair marketing, underwriting or claims practices.

This requirement of regular market conduct examinations forces the department to allocate valuable examiner resources to companies that may not present any risk of non-compliance or consumer harm. At the same time, it prevents those same resources from being used for foreign companies that do present a risk of harm to Washington consumers. Market analysis is needed to help the OIC identify those companies that present a risk of harm to Washington consumers and to focus resources on those companies .

One deficiency that was noted was the lack of a dedicated investigative unit to conduct investigations of insurers' practices. There are no resources for a quick response to a perceived compliance problem and this is an essential requirement of all market analysis initiatives. Many issues and potential compliance problems do not warrant an examination because only a single issue or practice is involved, an examination would take too long or the nature of the problem may not justify the expense. In addition, at the OIC there are simply insufficient examiners to handle that work. To the extent that other staff investigates insurers, it takes them away from their normal regulatory duties.

Finally, it is apparent that the OIC's computer system does not permit the type of data sharing, retrieval, analysis and reporting that is needed for a robust market analysis

program. There is a significant amount of information and data collected by various divisions that could be meaningful in monitoring the market. According to the staff, information is kept in “silos” and not readily available within the department. Even when data is collected, it is not always available in a usable format or reports are not available. The OIC is in the process of developing a new system.

RECOMMENDATIONS

Market Analysis Program

As mentioned above, market analysis develops almost daily as the NAIC's committees continually work on establishing standards, terminology, guidelines and priorities and the various states try to put those recommendations into practice. The states are continually making changes as they struggle to find the best ways to structure and staff a market analysis program. To the extent that the recommendations below are based on the work of NAIC committees, it is based on such work as of mid-October, 2005. All indications point to the need to have a strong, robust and yet flexible market analysis program that can adapt to not only changing market conditions and trends but also adapt to accreditation and uniformity standards as development of the standards continues.

Legal Authority

Without the proper legal authority, a market analysis program may be subject to legal challenges that could hinder a state's ability to monitor its insurance market. The OIC, like most insurance departments, has general investigative powers and some degree of authority to examine insurance companies' non-financial business practices. There is some level of confidentiality for certain records. Like many other departments, the OIC does not have adequately clear and express statutory authority to issue data calls, compel production of data and information perform market data analysis or to keep the data or the analysis confidential. To meet the current and developing standards for market analysis, the OIC needs clear legal authority to perform all of the major and incidental functions of market analysis including, data collection and analysis and the continuum of regulatory responses.

The ability to keep information and records confidential is necessary to satisfy the Core Competencies. At this time, it appears that each state may have some flexibility to determine the extent to which various records and information should be confidential. However, an inability to maintain a certain level of confidentiality may hinder market analysis efforts. The ability to keep information confidential that is received from another regulator or from law enforcement is also essential.

Another issue is whether a state should have any type of evidentiary privilege for self-audit materials. This issue can arise in the course of a regulatory review when an insurer refuses to risk a waiver of an existing privilege in order to share information with the regulator. Another situation arises when an insurer discovers its own non-compliance, corrects the problem and wants to let the regulators know what has happened. If the information is not privileged or otherwise protected by statute, many insurers believe there is a risk of disclosure and litigation. In both situations, a self-evaluative privilege or strong confidentiality protections would protect the insurer and still allow the regulator to review the information. Several states, including, Illinois, New Jersey, North Dakota, Oregon and Kansas have such protections, most of which are based upon a model law developed by the National Council of Insurance Legislators.

Finally, there is the issue of best practices organizations and what weight, if any, a market analysis program should give to membership in such organizations. There is a reference to best practices organizations in two places in the NAIC Market Conduct Surveillance Model. It seems logical that any program that can be effective in promoting actual compliance should be encouraged and should be given some level of consideration in market regulation and market actions.

For example, the Insurance Marketplace Standards Association (IMSA) has been trying to gain regulatory recognition for some time. In response to early criticisms from regulators, IMSA implemented significant changes to its requirements for accreditation including the addition of file testing, independence and conflict requirements for assessors and the addition of more independent board members, among other changes. Notably, in the past two years since those changes were implemented, six states issued bulletins specifically recognizing IMSA in market analysis and market regulation activities. Those states are New York, Texas, Massachusetts, Iowa, North Dakota and Maine.

The OIC's current unfair trade practices laws are substantially similar to the NAIC model and satisfy current standards.

Recommendations:

- 1. Legislation to expressly authorize market analysis and to permit the OIC to meet current and evolving standards. Draft legislation is attached in Appendix A. It is based on the NAIC Market Conduct Surveillance Model Act. To encourage self-audits and the sharing of the results with the OIC, specific confidentiality for self-audit materials that have been disclosed to the commissioner is included. Appendix A includes a clean version of the proposed legislation and a redlined copy of the model act. An alternative proposal for a self evaluative privilege is attached in Appendix B. It is based on the NCOIL model. Alternative draft legislation that provides for deference to the domestic regulator for routine market conduct examinations and, to some extent, targeted examinations, is attached as Appendix K. It is similar to recent legislation enacted in Texas. Finally, attached as Appendix L is draft legislation that would provide the OIC with the minimum authority necessary to collect data and information for market analysis and to keep such information and analysis confidential.*
- 2. The OIC should evaluate and encourage membership in best practices organizations. Attached as Appendix C is a proposed bulletin which provides that the market analysis program will take into consideration whether an insurer is a member of a best practices organization.*
- 3. The OIC can maintain its existing system for charging fees for market conduct examinations. A proposed amendment to RCW 48.03.060 is in*

Appendix D.

4. *The OIC should clarify existing law to expressly provide authority to take statements and issue subpoenas for market conduct actions. A proposed amendment to RCW 48.03.070 is in Appendix E.*

Market Analysis

To satisfy current minimum standards for market analysis, the OIC must continue to participate in and complete the baseline analysis for all insurers in major lines of business and complete Level 1 analysis using the automated Market Analysis Review System. Based on the results of Level 1 analysis, the staff should be able to identify certain insurers that warrant some type of regulatory intervention.

Although Level 2 analysis is not well defined at this time, there are many sources of information that can help the analyst further evaluate the insurer and the potential issues. What the analyst should be looking for is information that explains or confirms the results of the analysis or that elaborates on the nature of the company's business, its products and distribution channels. The NAIC Market Analysis Handbook includes a lengthy list of such research sources and a description of each one. Without repeating all of them, good sources of information include the company's financial statements (including the state page) , rating services, trade press, websites on matters such class actions and the company's own website and the company's self-audit results (if any).

The OIC also has information within the department that can be used more fully for market analysis purposes. Some of the information will be more usable with the new computer system. However, a strong market analysis program will ultimately depend on having more market data than is currently reported to the OIC. Many regulators acknowledge that analysis of complaints and financial information as currently required does not provide them with sufficient information to fully monitor their markets or identify all companies that may need regulatory intervention. Despite efforts to standardize market analysis, there will always be circumstances in particular states or markets that warrant additional analysis. There may be a perpetual problem in a particular market that needs regular scrutiny, an emerging issue or new legislation may produce a need for analysis of market activities. In those cases, specific data calls will have to be created and used as needed. However, there are some things that the OIC can do now to augment a basic analysis program.

Complaint analysis

Currently, the OIC does not make optimal use of its consumer complaint data. Complaint ratios are not prepared on a regular basis. To the extent they are, they are reviewed by the market conduct staff as part of their pre-exam review of a company. As mentioned above, the staff performed the minimum analysis required by the NAIC but had insufficient resources to perform any additional review or evaluation.

Complaint indices by line of business should be run and analyzed on a regular schedule in accordance with the instructions in the Market Analysis Handbook. Preparing the indices at approximately the same time every year will provide for more accurate trending and decrease the chances that a change in complaints may be due to a seasonal event. Ideally, consumer complaints would be analyzed and trended quarterly.

When a company has a relatively high complaint index and/or has other indicators of potential compliance problems, the consumer complaints filed at the department should be reviewed individually. The files should be reviewed to determine if there are any issues that appear repeatedly. For example, knowing that a company's complaints are all about underwriting fails to tell the analyst whether there is a specific practice that is the subject of the complaints. Only an individual file review will provide that level of detail and direct the analyst to specific practices or issues.

Trending complaint data can be very important. For example, a relatively high complaint ratio is generally a negative factor in market analysis but if the ratio is down significantly from the previous year then the decrease is a positive factor. Also, if complaints are trending downward, a less intrusive market action may be warranted because chances are the company has changed something in its operations that is reducing complaints.

Market Conduct Annual Statement

The OIC should consider participation in the Market Conduct Annual Statement (MCAS). The MCAS is an annual, market analysis tool that was developed by nine states in 2002. At least 17 states will participate in 2006. It provides relevant, state-specific market activity data about claims aging, non-renewal/cancellation rates, non-department complaint activity, replacement rates for life/annuity products and other market activity that is not currently available elsewhere. The technical requirements to participate are not significant but staff time is required. The MCAS currently uses Access databases. Data validity checks are built in to help analyst recognize erroneous data and reports have been developed.

By participating in the MCAS, the OIC would have the benefit of data on actual market activity for personal lines, life and annuity products that is not currently available elsewhere. The MCAS would provide meaningful analysis that will help the OIC monitor the Washington market. One of the benefits of using the same data call and analysis on an annual basis is the ability to trend the information from year to year. With multiple states using the same data and analysis, the statement also enhances the opportunities for determining whether identical problems are state-specific or national in scope.

It should be noted that some regulators have suggested that additional data elements would make the MCAS more helpful. A review of what those elements should be began recently and OIC staff should participate in those discussions. Also under consideration is whether the data should be collected at a centralized location and whether any of the data should be released in the aggregate by participating states.

Existing Data

The OIC recently released its Second Annual Medical Malpractice Insurance Report. The data that was collected and aggregated for this report provides a helpful gauge of certain activity in the market and the company-specific data would be useful in market analysis. For example, the report indicates that 27% of claims were closed without an indemnity payment. If, hypothetically, the industry average was 15% of closed claims are closed without payment and if one major carrier's percentage was 40%, that would present a question about whether improper claim denials are occurring. This would be particularly true if every other carrier's percentage hovered near the industry average. Similarly, the other data in the report should be identified separately for each company and outliers in each category noted. Assuming this is an annual report, it provides an opportunity to trend the data from year to year to see if there are changes in the overall market's performance and the performance of individual companies. The data should be accessible to the market analysis staff.

On the health side, the OIC receives a tremendous amount of company-specific information when health carriers file their access plans. In addition to network details, the department receives information about the use of best practice organizations like NCQA, how the company deals with a diverse clientele, how well the company educates and informs its members, details about provider compensation programs, coordination of care efforts, plans for continuity of care upon termination of a provider's contract or the carrier's insolvency and other information that informs the department about how each carrier is actually operating. Although some of the answers may be subjective, a scoring system can be developed, either for all answers or those identified as most important to consumer protection. This type of surveillance or analysis can be combined with the NAIC basic analysis to help identify companies that may warrant additional regulatory attention.

The department prepares annual liability reports for certain lines of business as required by statute. Putting this data into a useful format, broken down by line of business and by each company within each line is important. Although the NAIC basic analysis at the present time does not include commercial lines, the OIC is free to include those lines and this data is a good place to start. Again, the information needs to be in a database that is readily accessible to the market regulation staff and one from which reports can be generated for select data elements, by company and for the whole industry. A market analyst should review and trend the data annually. This particular data, including changes in premiums, losses, reserves, loss adjustment expenses and other information may signal a change in the particular market before complaints from consumers or trade associations do.

The Rates and Forms Division currently tracks rate changes for private passenger automobile insurance for the top 20 companies, roughly 73% of the market share. It is important to share such market allocation and rate change information with the market regulation unit and the market analysts must review it.

The Statewide Health Insurance Benefits Advisors (SHIBA) program collects client contact forms with information about the consumer and the health insurance-related problems of the consumer. However, it appears that there is a lack of consistency in the completion of these forms. That decreases the usefulness of the information. If the OIC is going to collect data and information related to SHIBA's work and consumer contacts, the information should be limited to the most useful data and information. The department should make a concerted effort to educate the SHIBA volunteers as to the importance of the information they collect. Shortening the client contact form and reducing the amount of requested information will likely increase the volunteers' cooperation and improve the credibility of the information and the ability to analyze it for trends, changes or emerging issues.

Recommendations:

1. *The OIC should analyze complaint indices at least twice a year for all major lines of business (individual health, group health, life, annuities, personal lines, commercial lines) and as needed for specialty lines. Each analysis should include trending for 3 or more periods or years.*
2. *The OIC should review individual complaint files for any company with a relatively high index or that otherwise stands out during any market analysis.*
3. *The OIC should participate in the Market Conduct Annual Statement.*
4. *Data currently collected by other divisions and their reports should be made available to the market conduct analysis staff.*

Use of NAIC databases

The use of the NAIC databases, reports and systems is essential to permit the OIC to meet current and evolving standards for market analysis, including the sharing of information and interstate collaboration.

To meet the current standards, the state must be submitting data to CDS, RIRS, SAD and ETS and must certify such submissions. Further, to meet current standards, all CDS and RIRS reports must be done electronically. In 2006, the NAIC will be reviewing standards for complaint coding and may institute data validity verification procedures for the CDS.

The Market Analysis Review System (MARS) is the new automated Level 1 analysis system which is in production this year. Its use will make market analysis more efficient and will make the analysis consistent with established standards.

In early 2006, the NAIC expects to have the Market Initiatives Tracking System (MITS) in production and the OIC should use it. This system is designed to provide a method of

tracking market actions such as informal reviews and investigations or other actions (other than examinations) on the continuum. It will enhance states' efforts to coordinate their market oversight activities is expected to become part of the core competencies.

Recommendations:

1. *The OIC must continue to timely submit data to the NAIC's market systems databases, including ETS, CDS, RIRS and SAD.*
2. *The OIC should use the MARS for Level 1 analysis.*
3. *The OIC should enter all market actions other than examinations into MITS when it becomes available.*
4. *The OIC's IS and Consumer Protection staff should monitor and implement changes to comply with NAIC efforts to improve the quality and validity of consumer complaints.*

Continuum of Regulatory Responses

A major issue that is often overlooked in discussions about market analysis is that the key to effective regulation is to not only to identify issues that may cause harm to consumers but to *act upon* the results of the analysis. Therefore, unless the OIC has the resources, skills and legal authority to act on the results of its market analysis it will not have an effective program to fully protect the consumers of Washington.

Being able to perform the continuum of regulatory responses is currently required as part of the Core Competencies, the NAIC Market Conduct Surveillance Model Act and is described in detail in the NAIC's Market Analysis Handbook. In addition, the SMART Act proposal refers to and would require states to adopt model acts such as the NAIC model. Being able to perform the continuum of responses means setting priorities and being able to determine the appropriate level of response to a particular problem.

The stated goal of having a continuum of responses includes a presumption that the state will use the least intrusive method that will satisfy the regulatory objectives and concerns given the nature and extent of the actual or potential problem. This means that the department should call a targeted exam only as a last resort or in the most extreme cases and should consider all other options first. Before choosing a regulatory response, the staff will have to fully consider, among other things, all potential aspects of the problem or issue(s), the actual or potential harm, the information needed for evaluation, how such information may be kept by the insurance company or other source, the time period under review, whether interviews of company personnel may be needed, the urgency and extent of the matter and whether it is a single issue or a more complex matter.

The following continuum of regulatory responses, also called market conduct actions, is a combination of those that appear in the NAIC's Market Analysis Handbook and Market Conduct Surveillance Model Law. In any given situation, there may be other techniques that could be used or multiple techniques may be appropriate for a particular matter. The goal is to use the least intrusive yet effective method. In order of least to most intrusive:

- Education of the Industry - Bulletins, notices, information posted on the department's website, seminars or training for the industry, summaries of market conduct findings.
- Correspondence - Letters and/or phone calls to resolve an issue.
- Interviews - Formal in person or telephone interviews and sworn statements.
- Targeted information gathering - A request for very specific information, generally for a limited period of time and/or limited to a specific practice or product.
- Policy and procedure reviews - These can be done for a single company (e.g. claims practices), for the whole market on a single issue (e.g. credit scoring). Rather than test files for compliance, the focus should be on whether the company's practices and procedures are reasonably designed to assure compliance. The review should include the company's controls to make sure policies and procedures are actually being followed.
- Interrogatories - Occasionally, an issue or concern is potentially complex enough that a series of specific questions should be asked to elicit the necessary information. Careful, unambiguous drafting is necessary to elicit meaningful answers.
- Self-Audit review - May be a follow-up to a previously identified and corrected problem, a change in policies and procedures or simply a way to have a company review and verify its activities.
- Voluntary compliance programs - Most insurers have some type of compliance programs. However, occasionally insurers will agree to implement a special program to resolve a particular issue and the regulator may want to approve the program and/or receive periodic reports.
- Desk Audits - These are often conducted like a traditional exam by testing company files and reviewing other information but are performed at the department. It is an option when issues are limited and company files can be copied or transferred easily.
- Investigations - An investigation can be simple or complex. They should be done in accordance with the Uniform Investigation Standards adopted by the NAIC.

An examination is often the most flexible means of getting to the bottom of a problem and is generally quicker than any examination.

- Targeted exams - When a broader review of a company's practices and testing for actual compliance is warranted, a targeted exam may be appropriate. A particular company may be targeted on certain issues or, sometimes, an emerging issue or compliance problem may warrant a limited scope exam of multiple insurers.
- Comprehensive exams - There has been an attempt in most market conduct reform initiatives to eliminate comprehensive examinations to the extent that they are done simply on a periodic basis and/or are not based upon market analysis. In some cases, if market analysis reveals some concerns about a new company in the state, those circumstances may justify a comprehensive examination.
- Collaborative exams - The current emphasis is for collaborative actions to be generated from the work of the Market Analysis Working Group. However, there may be other occasions, such when neighboring states share concerns about a regional company that a collaborative action is appropriate.

For uniformity purposes, the OIC must adopt and use the Uniform Investigation Guidelines, Uniform Examination Guidelines and Standardized Data Requests (for examinations) that have been adopted by the NAIC. Copies of the guidelines are included in Appendices F, G, and H.

Elimination of routine market conduct examinations of domestic insurers.

Market conduct examinations in the state currently focus primarily on domestic insurers and the staff indicated that the examinations are on a five-year cycle as required by statute. Concentrating market conduct examinations on domestic insurers means that many foreign companies with significant market share may not be examined and that compliant domestic insurers may be subjected to the time and expense of an examination.

With the exception of health insurance, a majority of the major lines of insurance are written by foreign insurers that are domiciled in other states. For example, the top seven insurance groups, by premiums, write 48.79% of the total property and casualty premiums in the state according to the Insurance Commissioner's Annual Report for 2003. Those seven groups are comprised of 52 separate insurance companies. Of those 52 companies, only 7 are domiciled in Washington and those 7 have a collective share of 14.34% of the market. In fact, the two largest writers include one domestic (Farmers Insurance Co. of Washington) with 6.44% of the market and one foreign company (State Farm Mutual Auto Insurance Company) with 6.46% of the market. The third largest writer is another foreign company (Allstate Insurance Company) with 4.80% of the market. Collectively, domestic insurers write only 21.6% of the entire market (as measured by premiums).

Similarly, for life insurance, the top ten groups write 44.98% of the business and consist of 48 different companies, none of which is domiciled in Washington. According to the Insurance Commissioner's Annual Report 2003, there are only seven life insurers domiciled in the state and collectively they write only 3.51% of the business (as measured by premiums).

Recommendations:

1. *The requirement to conduct market conduct examinations of domestic insurers on a periodic basis should be eliminated.*
2. *The OIC should conduct only examinations that are targeted to particular companies and/or issues or practices and that are based upon market analysis.*
3. *The current statutory authority to charge insurers for examination expenses and to pay NAIC rates should be retained.*
4. *Examination notice and reporting requirements should be reviewed and changed if necessary so that they are consistent with the uniformity guidelines. For maximum flexibility, notice and reporting guidelines could be promulgated in a regulation.*

Participation in the Market Analysis Working Group

Part of the requirements for the Core Competencies (and expected self-certification and/or accreditation standards) is active participation in MAWG, including participation in calls and/or attendance at meetings, the use of databases, and communicating with the domestic regulator of any company under review. The Market Analysis Chief serves as the principal liaison with the MAWG and should be the person to whom others within the department report market behavior information. This person is responsible for interdivisional communications and completion of required analysis.

The OIC currently has a person designated as the Market Analysis Chief who is actively involved and able to travel and participate in MAWG and collaborative actions.

1. *Recommendation: The Market Analysis Chief should continue to remain actively involved and permitted to travel to fulfill the obligations of the role.*

Interdivisional cooperation and sharing of information

To meet current standards for market analysis, divisions within insurance departments must have regular contact to share and discuss pending matters, emerging issues, company-specific information, compliance issues, potential red flags and other information. Frequent communications will often bring to light emerging issues or

concerns well before formal analysis will. These contacts should include the coordination of responses to problems and inquiries.

The best way to accomplish such beneficial exchanges of information is with regularly scheduled face-to-face meetings. Meetings allow for easy and spontaneous interactions. Meetings should occur monthly and certainly no less than quarterly. The Market Analysis Handbook recommends at least quarterly communications.

There must be a clear understanding of each division's functions and that all must actively share in the responsibility to note and bring attention to anomalies in company behavior or disturbing trends. All staff must be aware of common indicators and must be oriented to inform the Market Analysis Chief about other information or developments that may signal a problem in the insurance market of the state or with a particular insurance company. Although responsibility for market analysis may be centered in one division, ultimately it is a responsibility shared by all staff. Even without formal data analysis, there are red flags that experienced regulators will note and those should be communicated to the Market Analysis Chief at the monthly meetings or sooner. A formal list of indicators should be shared with all divisions with instructions from the commissioner to participate in sharing information and reporting indicators on the list or other concerns.

There is a list of indicators in the Market Analysis Handbook (p. 17) that includes such items as significant changes in market share, consumer complaint ratios, dramatic growth, changes in product mix, recent changes in ownership, high degree of reliance on third-parties to perform company functions (e.g. using MGAs), and problems with electronic data system, among others. However, there are many other red flags that an experienced regulator will note, including:

- ✓ Several sales or marketing complaints where the company willingly returns the premium and undoes the transaction.
- ✓ Consumer complaints indicating a policy surrender but no replacement forms.
- ✓ Company representatives who admit they are not familiar with the state's laws.
- ✓ Companies without compliance programs.
- ✓ Companies identified by financial examiners as having poor internal controls.
- ✓ Repeated problems in making accurate, complete or legal rate or form filings.

Such information must be communicated to the department's Market Analyst Chief or another designated person.

Recommendations:

1. *The Market Regulation Division should schedule monthly meetings with the following divisions: Company Supervision, Rates and Forms, Consumer Protection. It can be beneficial to have the attorneys that are assigned to provide support to the Market Regulation Division attend as well to make sure they are familiar with issues and to provide legal*

support early in the process. A minimum agenda should include each division sharing information about ongoing projects, new initiatives, any data or information collection efforts as well as identifying emerging issues and companies with potential compliance problems. A brief summary of each meeting should be prepared to memorialize the meetings.

2. *The OIC should identify a list of indicators and instruct all divisions to report to the Market Analyst Chief when any of those indicators are observed.*

Education

Effective regulation includes regular, educational efforts to keep the industry informed of regulatory changes, new laws, tips for staying in compliance and other information that can help insurance companies stay in compliance. Educational efforts are required by the NAIC's Market Conduct Surveillance Model Act and are discussed in the Market Analysis Handbook.

The department website is a convenient place to post information and there are many companies who review state insurance department websites for information they can use to stay in compliance. Information or summaries about new laws, recent findings or compliance issues can be extremely helpful to insurers. Outreach efforts, however, can reach other insurers that may not be so proactive. Other methods include individual company meetings, the use of bulletins, newsletters or other correspondence, news releases, interaction with trade associations, among others.

When a troublesome compliance or market conduct issue has been identified, particularly in multiple companies, a mass mailing to each licensed insurer in that line of business may generate sufficient attention to be worth the time and expense. For example, if a few companies are identified as being consistently non-compliant with the replacement rule, a letter reminding each company of the requirements may get the necessary attention (at least, in many companies).

Another inexpensive and timely means of alerting the industry about legislative changes and recent activities of the OIC is through an email alert system for press releases. Interested parties sign up electronically and receive copies of the press releases by email.

Insurers' compliance personnel generally welcome opportunities to meet with insurance department staff. Most try to be in compliance and opportunities to meet face-to-face with the regulators and ask questions may result in improved compliance. In addition, these types of meetings may provide the department staff with a better understanding of the business side of insurance. Such seminars may be more productive if organized by product or market rather than department division. For example, a seminar on personal lines might involve staff from the Market Regulation Division, Rates and Forms Division

and Consumer Protection. Trade association representatives should be able to identify the questions their members commonly ask to help the OIC plan a productive seminar.

Recommendations:

1. *Website enhancement. The market regulation division should appoint a person to be responsible for monthly updates of a webpage that is dedicated to market regulation issues, provides a summary of recent findings and violations and suggestions for compliance in those areas.*
2. *Compliance seminars. The OIC should host a series of compliance seminars at which the department could review procedures, address commonly asked questions and be available to answer questions.*
3. *Newsletter. The OIC should issue a periodic, electronic newsletter to insurers that is similar to its Agent & Broker E-Newsletter.*
4. *Correspondence. If market analysis reveals a common problem or a specific area of potential noncompliance, the OIC should consider issuing a letter to all insurers in that line of business reminding them of the legal requirements.*
5. *Press Releases. The department should institute an electronic means of registering for email distribution of department press releases.*

Interstate Cooperation

Interstate cooperation and collaboration is required in the Core Competencies, the NAIC Market Conduct Surveillance Model Act, the Market Analysis Handbook and the SMART Act proposal.

In the past year, the NAIC developed guidelines for collaborative actions and continues to establish priorities and to refine the role of MAWG in collaborative actions. Each state is required to have a person designated as the Collaborative Actions Designee who must be actively involved with MAWG and can attend MAWG executive sessions (in which particular companies and regulatory efforts are discussed) and participate in conference calls. The OIC should be prepared in terms of staffing and expertise to assume a leadership role in the event one of its domestic insurers or a major writer in the state becomes the subject of a collaborative action.

The draft Core Competencies provide that a state must be able to participate in the Market Analysis Working Group (MAWG) conference calls and surveys, timely participation in the NAIC databases, notify the CAD or MAC of an insurer's domestic state when considering a regulatory response, confirm the ability of a state to keep information confidential before sharing and follow the collaborative actions guidelines for making recommendations to MAWG.

Recommendations:

1. *The OIC should continue to appoint a Collaborative Actions Designee who is actively involved with MAWG and who can assume the lead in a collaborative action if needed.*
2. *Managers of the market regulation unit and the exam team must be familiar with and must follow the NAIC's Collaborative Actions guidelines.*

Uniformity for investigations and market conduct examinations

The NAIC has adopted a detailed set of procedural guidelines for investigations, for market conduct examinations and a set of uniform data calls. Current NAIC standards include the use of these guidelines and data calls and they are part of the Core Competencies. Uniform examination standards are also mentioned in the SMART Act proposal.

Recommendations:

1. *The investigation guidelines should be incorporated into the division's procedures.*
2. *The examination guidelines and standardized data calls should be incorporated into the division's procedures.*
3. *Staff must be trained and instructed to adhere to the investigations and examination guidelines, including the use of standardized data calls.*

Resources

Organization and Staffing

Staffing levels and qualifications are absolutely critical to the effectiveness of market analysis. Insurance is a regulated industry and the duty of the regulator is to protect insurance consumers. Staffing levels must be high enough to maintain an appropriate level of oversight of all insurance companies that are licensed in the state. For a state like Washington, that means the ability to monitor the activities of and take action as needed against approximately 1374 companies.

Currently, states are expected to perform a standard, minimum amount of market analysis. States' performance is scored. The OIC satisfied the criteria for 2004. The minimum analysis consists of the baseline, Level 1 and Level 2. From discussions with the OIC staff, it is apparent that the staff is barely able to meet these minimum requirements and was unable to conduct any additional reviews or take any other action as a result of the analysis. In other words, to the extent the analysis revealed any companies with potential compliance concerns, the OIC lacked resources to conduct any additional review to determine whether the companies were complying with Washington law. It appears that the statutorily required periodic examinations of domestic insurers required all available resources at the current staffing levels. Furthermore, the OIC lacks a dedicated unit to conduct any non-examination reviews of the market activities of insurers.

Organizational Structure

A separate market regulation organizational unit that is responsible for all market analysis functions from data gathering and analysis to market conduct exams is optimal. The market regulation unit could be a separate division of the OIC or combined with another division. If the unit is to be combined with another division, it would be logical to include it within the current Company Supervision Division because of the similarities between the work and responsibilities. The other states that were contacted perform market analysis functions within the state's market conduct program. Some, like Arizona, have reconfigured their staff and duties. Florida has tried to create an analysis unit as a separate unit within the market conduct program.

To fully perform all market analysis and related regulatory functions that are currently expected and that are expected to be required in the future, the market regulation division should be composed of three teams. The first would be the Analysis Team. The second would be the Market Action Team and the third would be the Exam Team. The work of the Analysis Team would be the primary driver for the work of the other two teams.

The Analysis Team should have primary responsibility for monitoring the insurance market, identifying emerging issues and problems, and targeting companies that appear to need regulatory attention. The Analysis Team should be able to perform appropriate

analysis and research details about an insurer's background, lines of business, new products or marketing, news releases, class actions, and other recent history of a company. The research of the Analysis Team would generally be limited to research and evaluation that does not require direct contact with the insurer. After further analysis and evaluation of outliers the team would recommend selected companies for market actions.

The Analysis Team would also be responsible for on going review of trade press and other sources of current, up-to-date information about different segments of the industry, product innovations, news about particular companies and, in general, keeping up with what is happening in the insurance industry.

The Market Action Team would take over when target companies have been identified for some type of regulatory response. Based on the research and evaluation of the Analysis Team, the Market Action Team will perform the various actions along the continuum of responses except for examinations or desk audits. The latter would be performed by the Exam Team.

The enforcement function does not have to be part of the market analysis program and the OIC will have to determine where to position its enforcement activities. To maintain some independence, it can be beneficial to have the Legal Division prepare all legal documents (orders, consent agreements, etc) and conduct negotiations. The OIC currently maintains this separation in most situations. This structure provides another, objective review of the findings of an underlying investigation or examination. The OIC already has a unique enforcement mechanism in place with its compliance group. One of the advantages of having this group determine appropriate resolutions is that it involves deputies from other divisions. Any sanction may have an effect on other divisions and other divisions are uniquely suited to know other aspects of the company. For example, a resolution may require certain changes to policy forms that would affect the Forms & Rates Division. A significant fine might have a financial impact.

Staffing Levels

The OIC is responsible for approximately 1374 licensed insurers, among other licensees. There is no current industry standard for the number of staff required to properly oversee the market activities of that many insurers but a comparison with the OIC's own staff for financial regulation can be a basis for comparison. The OIC is accredited by the NAIC for purposes of regulating the financial solvency of insurers. The qualifications and number of staff are considerations during that accreditation process.

Within the area of financial regulation, there is domestic deference, meaning that the OIC has primary responsibility for only its domestic insurers of which there are approximately 60. There is some responsibility for all insurers but the primary responsibility is for domestic insurers. On the market side, however, the OIC is responsible for the market conduct of all 1374 insurers doing business in the state. Currently, there is no domestic deference on the market side of insurance regulation.

The Company Supervision Division has 17 financial examiner positions, 5 supervisors or higher level examiners, an Assistant Chief Examiner and a Chief Examiner. In addition, there are 6 financial analyst positions and a Chief Financial Analyst. Therefore, a staff of 31 is responsible for the financial analysis and regular examinations of insurers in the state of Washington. Counting all insurers, there is a company to staff ratio of 44 companies for each staff person. Counting just domestic insurers, there is a company to staff ratio of 1.9 companies per staff person. Because the market side has responsibility for the market conduct of all licensed insurers and is expected to conduct analysis as well as inquiries, investigations, other reviews and examinations, the market regulation division should have similar staffing levels.

When fully operational and staffed, the Market Regulation Unit should consist of a manager and three teams, each with a supervisor and administrative support person. Because of the number of insurers operating in the state and the increasing responsibilities and expectations for market analysis and collaborative actions, each team will need eight staff to adequately perform the necessary functions. The Analysis Team should have eight Market Analysts. The Market Action Team should have eight Compliance Analysts. The Exam Team should have eight examiners. The unit should be supported by the equivalent of two full-time attorneys in the Legal Division.

We recognize that, currently, only one person is performing the minimum market analysis expected by the NAIC with some oversight by her supervisor. We also recognize that staff in the Rates and Forms Division and the Consumer Protection Division currently conduct inquiries and investigations that sometimes result in administrative actions against insurance companies and other regulated entities. Both of those divisions currently perform some analysis functions such as complaint analyses and rate filing and market share analyses. It is expected that all of such activities will be performed by the Market Regulation Unit.

When fully staffed, the Market Regulation staff should consist of 31 individuals with support from two attorneys. In developing this staffing level, we considered the work done in other divisions and the minimum analysis work that is currently performed by the Market Conduct section. We estimate that there are a total of three FTEs, plus the existing the six market conduct examiners, that currently perform work that will continue to be performed by the new unit. That work consists of investigations or inquiries performed by the Rates and Forms Division when necessary, complaint analyses performed by the Consumer Protection Division, the basic market analysis and the market conduct exams that are currently performed by the Market Conduct section. This means the total number of new staff needed will be 24 to 28.

It may be possible to transfer some existing staff to the new unit. However, it is our impression that some of the investigative work performed by these divisions is done in addition to their regular duties. It is questionable whether staff can be reassigned without a negative affect on other responsibilities of the OIC. In other words, with a dedicated Market Regulation Unit, the other divisions can concentrate on their primary regulatory functions of helping consumers and analyzing rate filings and policy and other forms.

We would expect that the current staff of the Market Conduct section would be assigned to the Market Regulation Division.

Implementation Schedule

The implementation of the market analysis program and the addition of necessary staff should be incremental to allow a core staff to develop some expertise and to allow the OIC to establish priorities and internal guidelines. Most of the duties that will be performed by the market regulation unit are new duties that will improve the OIC's oversight of the market conduct of insurers. Also, market analysis continues to develop on a national level and the standards for accreditation yet to be finalized. An incremental program will provide the flexibility to adjust to changing circumstances and provide for manageable growth.

The following three-year implementation schedule is recommended.

Year One

Goal: By the end of Year One, a Market Regulation Unit that consists of a manager, supervisor, three market analysts, three compliance analysts, an administrative support staff and the existing level of market conduct examiners (6).

Assign an existing staff person to manage the unit.

Assign or convert one examiner position to Market Analyst (to maintain existing expertise).

Backfill the examiner position to maintain current examiner staff level.

Assign one existing administrative support position to Market Regulation.

Add two new market analyst positions.

Add three new compliance analyst positions.

Add one new market analyst supervisor. (This person can also oversee the compliance analysts until more staff is added.)

Total new staff: 7

Year Two

Goal: By the end of Year Two, a Market Regulation Unit that consists of a manager, five market analysts, five compliance analysts, the existing level of six market conduct examiners, two supervisors, two administrative support staff and that is supported by a FTE attorney.

Add two new market analyst positions.

Add two new compliance analyst positions.

Add one new market actions supervisor.

Add one FTE attorney to support the Market Regulation Unit.

Add one administrative support staff.

Total new staff: 7

Year Three

Goal: By the end of Year Three, a Market Regulation Unit that consists of a manager, three supervisors, eight market analysts, eight compliance analysts, eight market conduct examiners, three support staff and that is supported by two FTE attorneys.

Add three new market analyst positions.

Add three new compliance analyst positions.

Add one new supervisor.

Add two new market conduct examiners

Add one FTE attorney to support the Market Regulation Unit.

Total new staff: 10

It should be noted that by Year Three, as market analysis continues to develop on a national level and as the number of collaborative actions increase, and as the OIC conducts more analysis and market actions, the OIC should consider whether these projections should be modified to adapt to changing circumstances. By then, additional accreditation standards or Core Competencies may be established that would cause the OIC to adjust these projections. It is possible that more compliance analysts and fewer market analysts will be required or vice versa, depending on future events.

Skills and Knowledge

In analyzing the needs of the OIC and in making recommendations for staffing, certain titles have been used. The OIC should feel free to revise or adopt any titles or names as it sees fit. The only two specific designations or titles that are currently required by the NAIC are the Market Analysis Chief (CAD) and the Collaborative Actions Designee (CAD). To comply, the OIC merely needs to identify an individual(s) for those responsibilities, regardless of the state-imposed title for such person(s). The same person can serve in both capacities.

Unique and various skill sets are necessary in market analysis. The ability to manipulate and analyze large volumes of data, import and export data files, access data through other databases and other technical skills are also critical. A knowledge of insurance and preferably expertise in certain lines of business is necessary to develop data calls, know what information is relevant and what information is available, and understand the significance (or lack of significance) of the findings. Other individuals within the market regulation program must have investigative skills along with a knowledge of the industry. To date, all regulatory reform initiatives have included some measure of market conduct examinations so examiners will continue to be needed. Legal advice throughout investigations, examinations and in enforcement actions will help provide optimal results. Finally, managers and staff within the program must have a clear understanding of all of the functions of the insurance department. A description of the necessary competencies is included in Appendix I.

Specialization of staff by line of business can be beneficial. Health insurance, in particular, is highly specialized. There can be drawbacks, however, when staff is assigned to and only familiar with property and casualty or with life insurance. On occasion, it may be necessary for the division to review an emerging issue across an entire industry, such as the use of credit scoring or sales of variable life insurance. The division's ability to handle a broad project like that is limited when staff is highly specialized and limited to certain lines of insurance. If specialization is desired, there should be opportunities for cross-training. Cross-training and the occasional ability to work with another line of business will increase the value of each staff person and make the division more flexible and more able to respond quickly when a problem arises.

NAIC Required Positions

Market Analysis Chief. To fulfill the requirements for this position as established by the NAIC, the person should be a mid-level manager, at least, with strong insurance industry and product knowledge, a basic understanding of statistics and familiarity with the state's insurance market, insurance laws, insurance regulation in general and all lines of business. This person must also be able to identify industry trends, recognize emerging issues and potential compliance problems. Prior market conduct examination, insurance investigation and/or enforcement experience would be desirable. The ability to travel in and out of state is necessary. Good writing skills are necessary. It would be appropriate for the manager of the market regulation division/unit or the Analyst Supervisor to serve as the Market Analysis Chief (CAD).

Collaborative Actions Chief – To fulfill the requirements for this position as established by the NAIC, the person needs good communication skills and the ability to work with regulators from other states and NAIC staff. This person must have sufficient leadership abilities so that he or she can represent the OIC at MAWG meetings or lead a multi-state collaborative initiative if necessary. The person should have prior market conduct examination experience and must be able to travel both in and out of state. The person who serves as the Collaborative Actions should be a mid-level manager and could be a supervisor or manager of either the exam team or the market action team.

Support

In order to maintain some independence and objectivity, the attorneys assigned to support the Market Analysis Division should not be a part of the division but should provide legal advice and support in the following areas: the interpretation of statutes and regulations, determining whether certain conduct constitutes an actionable violation, the sufficiency of evidence in a particular case, confidentiality and trade secret issues as they may arise, the administrative hearing process, attendance at meetings (especially when company attorneys are present), issuing subpoenas intervention when a company refuses to provide information, taking sworn statements, drafting of orders and other final documents and negotiations. Attorney support is particularly important when the state is involved in a collaborative action, either as the lead state or as a participant since all

states have somewhat different administrative procedures, forms and standards for resolving market conduct problems.

The attorney should understand the business of insurance, be familiar with the insurance laws and regulation in general, and should have experience (including negotiating experience) in either civil litigation or criminal prosecutions. It is unlikely that a single attorney will have sufficient expertise in all lines of insurance so it may be appropriate to have two or more who are familiar with different lines of business and who have the other requisite legal skills.

Administrative Support

Obviously, sufficient administrative support is also important and there should be at least one support person per team.

Recommendations:

1. *The OIC should form a Market Regulation Unit as part of the Company Supervision Division or as a separate division.*
2. *The OIC should increase its total market regulation staff to include a total of 8 market analysts, 8 market investigators, 8 examiners, a manager and three supervisors. The OIC should consider a three-year implementation schedule to provide for controlled growth and flexibility as national standards develop.*
3. *A description of the necessary skills, knowledge, abilities and general competencies for each position is included in Appendix I. The OIC should provide the equivalent of 2 full-time attorneys to support to provide legal support to market regulation unit.*
4. *The OIC should provide adequate administrative staff to support the market regulation unit.*

Non-Staff Resources

Computer system requisites

The OIC is in the process of developing an entirely new and integrated system. There are obviously many options available for systems but to permit a strong and effective market analysis program, the system must be able to meet the following requirements.

- Full utilization of NAIC databases and information systems, I-SITE features and reports, the ability to use the new Market Analysis Review System and the Market Initiatives Tracking System (MITS), ability to submit data electronically, and the

flexibility to adapt to changing requirements.

- Ability to download data from all of the NAIC databases.
- Ability to provide electronic access of one division's data and reports to other divisions. Each division must be able to generate reports from another's data. Access may need to be limited in some circumstances for confidentiality purposes or, in some cases to view-only access.
- The ability for insurers to submit requested data and information using the internet, ability to accept text files and d-base files by email. Security systems will have to accept such web and email filings. Large email capabilities will be required.
- Microsoft Office products, such as Excel, Access, Word and mail-merge capabilities.
- For participation in the Market Conduct Annual Statement, Access 2000 or XP is required currently. In the near future, it is likely that data will be submitted directly to the NAIC and each state will need the ability to access the data, run reports and download the data as needed.
- Department databases must provide for flexibility, combining data from different divisions and ease in creating reports.
- The ability to combine and trend data from multiple periods is essential.
- Electronic submission of complaints to the CDS and administrative actions to RIRS.
- Large network storage and fast processing. Ideally, market analysis should have a dedicated server. Otherwise, the large volumes of data may have a negative effect on the operations of other divisions, email functions or network speed.
- Security for the department's databases and electronic records is essential given the sensitive and confidential nature of the market data and analysis.

Recommendations:

1. *The OIC should assure the development of a system that meets the above requirements.*
2. *Because of the ongoing work at the NAIC, the IS staff should have regular contact with the NAIC's technical experts to be certain that the system is developed to conform with any changes made subsequent to this report.*

Other Resources

Training and travel resources are necessary for a strong market analysis program. This is due in large part to states' efforts to coordinate their work and collaborate on market actions or examinations when it makes sense to do so and to establish uniformity standards for analysis, investigations, data collection, and examinations.

Generally the only source for market analysis training that will help the OIC's staff learn and conform to these standards is the NAIC. Some but not all of it is online. For example, to stay current with market analysis developments, at a minimum, at least one market regulation staff should attend the NAIC's annual E-Regulation Conference.

Attendance at quarterly MAWG meetings, interim NAIC meetings at which standards and processes for market analysis are being developed and meetings of collaborative actions committees cannot be emphasized too much. Among other things, these meetings inform the attendees about serious compliance problems at various companies that have been identified by other states, provide a forum for exchanging ideas for handling problems and for resolving issues and provide opportunities for lead states to update other participating states about the status of collaborative actions.

Recommendations:

1. *The OIC should continue to send a Market Analysis Chief to quarterly NAIC meetings to attend the MAWG meetings and to interim NAIC meetings at which market analysis development work is occurring. This may be up to 8 meetings a year.*
2. *The OIC should continue to send its Collaborative Actions Designee to quarterly NAIC meetings to allow participation at collaborative actions meetings, including special company-specific meetings, and to participate in conference calls.*
3. *The OIC should establish a travel budget that permits at least two market regulation staff to attend the NAIC E-Regulation Conference and two to attend one additional training session.*